

DOCUMENT RESUME

04313 - [B3354609]

Contracting for Military Exchange Concessions. FPCD-77-79;
B-148581. November 30, 1977. 21 pp.

Report to Rep. Dan Daniel, Chairman, Nonappropriated Fund Panel,
House Committee on Armed Services: Investigations Subcommittee;
by Elmer B. Staats, Comptroller General.

Issue Area: Federal Personnel Management and Compensation:
Morale, Welfare, and Recreation Activities (312).

Contact: Federal Personnel and Compensation Div.

Budget Function: National Defense: Department of Defense -
Military (except procurement & contracts) (051).

Organization Concerned: Department of Defense.

Congressional Relevance: House Committee on Armed Services:
Investigations Subcommittee; Senate Committee on Armed
Services.

Authority: Service Contract Act of 1965. Rehabilitation Act of
1973. Wagner-O'Day Act. P.L. 87-849, sec. 2. 18 U.S.C. 283.
18 U.S.C. 207. 37 U.S.C. 801. 15 U.S.C. 631. A.S.P.R. 1-706.
A.S.P.R. 1-702. Small Businesses. Haircuts. DOD Directive
5500.7.

Contracts to commercial businesses to run concessions on military installations are awarded to responsive businesses offering the most favorable prices or fees, regardless of business size. The military exchanges have no policies or procedures specifically to protect small businesses by using nonappropriated funds to procure their services although they have policies for procurements made with appropriated funds. Findings/Conclusion: Review of the Army and Air Force Exchange Service contracting management showed that small businesses successfully complete contracts, but large businesses have received contracts and a greater share of some personal services in recent years. Procedures were adequate to keep contractors from "bumping" and there was no evidence that former employees unduly influenced concession contracting. Haircut prices were reasonable, but Army recruit haircut prices should be kept low throughout basic training. Recommendations: The Secretary of Defense should require the Army and Air Force Exchange Service contracting officers: to adequately document reasons why contracts are awarded early; to make sure that documentation to support contract changes is adequate for making such determinations at the time of the change and for postevaluation; and to offer reduced prices on follow up Army recruit haircuts. (Author/SC)

~~RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations~~

Released
3/15/78

**REPORT OF THE
COMPTROLLER GENERAL
OF THE UNITED STATES**



Contracting For Military Exchange Concessions

Small businesses successfully competed for concession contracts, but large businesses have received contracts to provide a greater share of some personal services in recent years.

Army and Air Force Exchange Service procedures were adequate to prevent

- contractors from "buying-in" (offering so low on a contract that they make no profit or a loss with the expectation that changes could be made after award to make the contract more profitable) and
- former employees from unduly influencing concession contracting.

Recent Army and Air Force Exchange Service policy permits lower prices on initial Army recruit haircuts, but prices were not lowered for later recruit haircuts.

4609
04313



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-148581

The Honorable Dan Daniel, Chairman
Nonappropriated Fund Panel
Subcommittee on Investigations
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This report is in response to the October 1, 1976, request of the Chairman of the Panel on Commissaries and Exchanges that we determine whether the policies and procedures of the military exchanges preclude small businesses from participating in concession contracts, prevent buying-in, and prevent former exchange employees from influencing the award of concession contracts. The Chairman also requested that we review the reasonableness of recruit haircut prices.

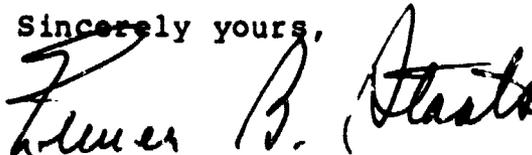
As requested by your office, we did not obtain formal comments from Department of Defense officials. However, we discussed the results of our work with them and their comments were considered.

This report contains recommendations to the Secretary of Defense. As you know section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

B-148581

As arranged with your office, we plan no further distribution of this report until it is released. At that time we will send copies to the Department of Defense and other interested parties and make copies available to others upon request. We will soon be in touch with your office to arrange for its release and to set in motion the requirements of section 236.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Homer B. Starks". The signature is written in a cursive style with a large initial "H" and "S".

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE
NONAPPROPRIATED FUND PANEL
SUBCOMMITTEE ON INVESTIGATIONS
HOUSE COMMITTEE ON ARMED
SERVICES

CONTRACTING FOR MILITARY
EXCHANGE CONCESSIONS

D I G E S T

Military exchanges award contracts to commercial businesses to run concessions on military installations. Regarding Army and Air Force Exchange Service contracting and management:

- Small businesses successfully competed for contracts but large businesses have received contracts to provide a greater share of some personal services in recent years.
- Procedures were adequate to keep contractors from "buying-in" (bidding so low on a contract that they make no profit or a loss with the expectation that changes could be made after award to make the contract more profitable).
- GAO found no evidence that former employees unduly influenced concession contracting.
- Haircut prices were reasonable, but Army recruit haircut prices should be kept low throughout basic training.

SMALL BUSINESSES SUCCESSFULLY
COMPETED FOR EXCHANGE
CONCESSION CONTRACTS

Contracts were awarded (after competition) to the responsive businesses offering the most favorable prices or fees, regardless of business size. The exchanges had no policies or procedures to specifically protect small businesses by using nonappropriated funds to procure services from them. They have policies for procurements made with appropriated funds.

The exchanges had not classified concession contractors according to size, nor did they have the data needed to do so. Army and Air Force Exchange Service contracts for its 10 largest dollar-volume services showed that firms known or assumed to be small held contracts accounting for about 63 percent of all income from services. (See p. 6.)

Exchange Service officials believed a small business set-aside program was not needed for its nonappropriated-fund procurements because small businesses competed effectively under existing policies. The officials contended that such a program would cause higher procurement costs and, therefore, would conflict with the Exchange Service mission to provide goods and services at the lowest practicable cost. (See p. 7.)

Small businesses were successful, overall, in competing for exchange concession contracts, but in recent years large businesses have received contracts to provide a greater share of barber and beauty services and some others. (See p. 9.)

Some contracts had been awarded in less than the normal 30-day leadtime and thus may have discouraged small business participation. GAO is recommending that the Secretary of Defense require that Army and Air Force Exchange Service contracting officers adequately document reasons why contracts are awarded early. (See p. 10.)

EFFECTIVENESS OF PROCEDURES TO PREVENT BUYING-IN

Buying-in is the practice whereby a contractor attempts to obtain a contract knowingly making an offer which will result in no profit or a loss, with the expectation of having the contract changed after award to make it more profitable.

Exchange Service

- regulations recognize buying-in as undesirable and contain specific steps to discourage it and
- procedures adequately prevent buying-in on concession contracts.

Generally, the procedures were followed; but in some instances poorly documented files prohibited GAO from determining whether price and fee adjustments were warranted. (See p. 14.)

GAO is recommending that the Secretary of Defense require that documentation to support contract changes is adequate for making such determinations at the time of change and for postevaluation. (See p. 14.)

EMPLOYMENT OF FORMER EXCHANGE EMPLOYEES BY CONTRACTORS

Postemployment prohibitions that apply to former exchange employees and officers are identical to those applicable to appropriated-fund employees and military personnel. Generally, a former Government employee cannot work as an agent or attorney for anyone other than the Government if the employee "substantially participated" in similar work at the previous job. Additional restrictions apply to retired regular officers. (See pp. 15 and 16.)

The exchanges award most concession contracts competitively. A former exchange employee would not have direct access to confidential bid information that would give a new employer an unfair competitive advantage without collusion with a current exchange representative. A former exchange employee's expertise could help concessionaire better manage a concession contract, but the procurement-related information he or she has to offer would be available to all interested bidders. (See p. 16.)

GAO found no evidence that former employees were unduly influencing concession contracting.

REASONABLENESS OF PRICES
CHARGED RECRUITS FOR HAIRCUTS

Prices charged recruits are the result of pricing policies established independently by each exchange system. As of February 28, 1977, recruit haircut prices ranged from \$0.62 for Marine recruits at Parris Island Recruit Depot to \$1.25 for Navy recruits at Great Lakes Naval Training Center. (See p. 19.)

Because their haircuts generally take less time, all recruits pay a reduced price for one or more of the haircuts they receive during basic training.

Haircut prices for Army recruits were made more equitable in February 1977 by greatly reducing the price of the recruits' first haircuts. However, GAO found no compelling reason why the Army recruit should receive a reduced price only on the first haircut while other recruits benefit from reduced prices throughout the basic training periods. Except for this apparent inconsistency, haircut prices for recruits are reasonable when compared with prices charged other personnel. (See p. 20.)

GAO is recommending that the Secretary of Defense require the Army and Air Force Exchange Service to offer reduced prices on follow-on Army recruit haircuts. (See p. 21.)

As requested by the Panel, GAO did not obtain written comments from the Department of Defense but discussed matters in this report with Defense officials and considered their view in its preparation.

C o n t e n t s

		<u>Page</u>
DIGEST		1
CHAPTER		
1	INTRODUCTION	1
	Background	1
	Scope of review	2
2	SMALL BUSINESSES SUCCESSFULLY COMPETED FOR EXCHANGE CONCESSION CONTRACTS	4
	Policy on protecting small businesses	4
	Exchange nonappropriated- and DOD appropriated-fund policies differ	5
	Small businesses account for majority of concession receipts	5
	Should nonappropriated-fund procure- ments be subject to small business set-asides?	7
	Possible effect of a small busi- ness set-aside on exchange prof- its	8
	Awards of contracts with short leadtimes may benefit large businesses	9
	Conclusion and recommendation	9
3	EFFECTIVENESS OF PROCEDURES TO PREVENT BUYING-IN	11
	AAFES procedures to prevent buying-in	11
	Initial contract	11
	Contract renewals	12
	Analysis of selected contracts	13
	Navy and Marine Corps procedures to prevent buying-in	14
	Conclusion and recommendation	14
4	EMPLOYMENT OF FORMER EXCHANGE EMPLOYEES BY CONCESSION CONTRACTORS	15
	Prohibitions imposed by statute	15
	Competitive concession procurements reduce risk of undue influence by former employees	16
	Proposed policy change by AAFES	17

CHAPTER

Page

5	REASONABLENESS OF PRICES CHARGED RECRUITS FOR HAIRCUTS	18
	Type and frequency of recruit haircuts	18
	Pricing policies vary among the services	19
	Army and Air Force	20
	Navy and Marine Corps	20
	Conclusion and recommendation	20

ABBREVIATIONS

AAFES	Army and Air Force Exchange Service
ASPR	Armed Services Procurement Regulation
DOD	Department of Defense
GAO	General Accounting Office
NAVRESO	Navy Resale System Office
SEA	Small Business Administration

CHAPTER 1

INTRODUCTION

By letter dated October 1, 1976, the Chairman, Panel on Commissaries and Exchanges, 1/ House Committee on Armed Services, expressed the Committee's concern with the trend of the exchanges, especially the Army and Air Force Exchange Services (AAFES), toward awarding concession contracts to large businesses to the exclusion of small ones.

The Chairman requested that we determine whether exchange concession contracting and related management procedures and policies

- preclude small businesses from successfully participating as exchange concessionaires,
- protect the interest of the exchanges and their customers and prevent "buying-in" by contractors,
- effectively prevent former exchange employees from influencing the award, renegotiation, or management of concession contracts through employment with concessionaires, and
- are consistent with postemployment policies and procedures applicable to appropriated-fund employees and military personnel.

The Chairman asked for our view on whether policy or legislative changes are needed to insure that the services' exchange concession contracting policies and procedures are fair to the exchange services, their contractors, and the Department of Defense (DOD) personnel they serve. We also were about to determine the reasonableness of recruit haircut prices.

BACKGROUND

The mission of the military exchanges is primarily to provide merchandise and services to authorized patrons at the lowest practicable cost and secondarily to generate, through earnings, funds to support other morale, welfare, and recreational programs.

From its headquarters in Dallas, Texas, AAFES operates a centrally managed and directed exchange system. Army and Air Force installation commanders may suggest exchange

1/Renamed Nonappropriated Fund Panel.

operations improvements, but operational responsibility for the exchanges rests with AAFES.

The Navy Resale System Office (NAVRESO), Brooklyn, New York, directs the Navy exchanges, and the Marine Corps Exchange Service Branch, Quantico, Virginia, directs the Marine Corps exchanges. These two headquarters guide and assist their exchange systems, but installation commanders have operational responsibility for the exchanges.

The exchanges provide a variety of personal services to their patrons, including barber, beauty, laundry and dry cleaning, photographic, watch repair, and optical services. AAFES' policy is to provide these services under concession contracts with commercial firms, if practicable, and it provides most of them in this manner. NAVRESO's policy is to provide these services in-house with exchange employees, and it attempts to keep contracts for personal services to a minimum. The Marine Corps Exchange Service Branch has no written policy concerning the means by which these services should be provided, leaving it to the discretion of each installation commander; about half of its services are concessionaire operated. For fiscal years ending in January 1976, concession gross sales in the continental United States totaled about \$76 million for AAFES, \$9.5 million for the Marine Corps exchanges, and \$5 million for NAVRESO.

As of January 1977, AAFES had about 1,600 personal service concession contracts and the Navy 39. The Marine Corps Exchange Service Branch did not have data accumulated by number of contracts, but had 45 contractors with annual concession sales of over \$10,000 each.

SCOPE OF REVIEW

Our primary effort was directed at the policies and procedures of AAFES, with particular emphasis on barber and beauty shop concession contracting. We also visited NAVRESO and the Marine Corps Exchange Service Branch to discuss their policies and procedures on concession contracting. We reviewed pertinent policies and regulations, interviewed exchange service personnel, and obtained data from various exchanges. We also visited Fort Leonard Wood, Missouri, to interview a former AAFES barber contractor and observe recruit haircutting.

We limited our review to personal services sold under concession contracts and selected for review the 10 personal

services with the largest sales. These 10 services accounted for about 99 percent of AAPES' total sales under concession contracts (exclusive of food, books, and periodical sales) and a large percentage of such sales by the Navy and Marine Corps exchanges. (See p. 6.)

At AAFES headquarters we analyzed contract and related data for the selected services provided at 37 (27 percent) of the Army and Air Force installations located in the continental United States. We obtained data on concession contracts awarded by the Navy and Marine Corps exchange services.

We requested the Small Business Administration (SBA) to tell us whether selected contractors were large or small businesses under SBA's size criteria.

CHAPTER 2

SMALL BUSINESSES SUCCESSFULLY COMPETED

FOR EXCHANGE CONCESSION CONTRACTS

Small businesses successfully competed for exchange concession contracts even though small business protection programs, such as the set-aside, were not required in military nonappropriated-fund procurements. Many contracts were awarded within less than the normal 30-day leadtime. In recent years, however, large businesses have received contracts to provide a greater share of certain services.

POLICY ON PROTECTING SMALL BUSINESSES

15 U.S.C. 631 provides that

"* * * the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government * * * be placed with small-business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation."

A small business is independently owned and operated, does not dominate the field of operation in which it is bidding on Government contracts, and meets the size standard established by SBA for the particular industry involved. For general services of the type considered in this review, a business would be classified as small under SBA criteria if its average annual receipts, including those of its affiliates, do not exceed \$2 million (\$4 million for laundry service) for its preceding 3 fiscal years.

The Armed Services Procurement Regulation (ASPR) sets forth the Department of Defense's basic procurement policies relating to small businesses. ASPR 1-702 states that it is DOD's policy to place a fair portion of its total purchases and contracts with small businesses. In furtherance of that policy, ASPR 1-706 provides that certain procurements shall be set aside for the exclusive participation of small businesses.

ASPR applies to procurements made with appropriated funds and, therefore, is not binding upon exchange procurements of goods and services with nonappropriated funds.

Exchange nonappropriated- and
DOD appropriated-fund policies differ

The exchanges' procurement policies generally require that personal service contracts be negotiated and awarded on the basis of full competition. Awards generally are made to the responsive and responsible business, regardless of size, offering the most favorable price or fee (highest return of gross sales to the exchange).

We found no exchange policies or procedures relating to nonappropriated-fund procurements which were designed specifically to protect the interest of small businesses. The exchanges had minority business set-aside programs which appeared to benefit primarily small businesses, but contracts awarded under those programs could not be renewed after 2 years.

SMALL BUSINESSES ACCOUNT FOR
MAJORITY OF CONCESSION RECEIPTS

The exchanges had not classified concession contractors according to size and did not have the data needed to do so. This lack of basic data made it impracticable to try to precisely determine the extent to which large and small businesses held concession contracts. Exchange officials contended that small businesses overall were very successful in getting concession contracts. An AAFES official acknowledged that large firms were being awarded contracts to provide a greater share of such services as barber and beauty and believed the trend would continue.

We identified the firms having the largest contracts for AAFES' 10 largest dollar-volume services and requested SBA to determine, using its size criteria, whether these firms were large or small. As of August 1976 businesses known or assumed ^{1/} to be small held contracts accounting for about 63 percent of the total receipts for these services.

^{1/}We limited the request of SBA to those firms with the largest contracts because of the time-consuming process required for SBA to make a size determination on each individual firm. Thus, some large businesses not holding large contracts with AAFES may not have been identified.

The table below of AAFES concession sales for its 10 largest dollar-volume services shows that small businesses were very successful in obtaining contracts for the largest dollar-volume service but less successful in competing for other services.

<u>Service</u>	<u>Large businesses</u>			<u>Small businesses</u>		
	<u>Amount</u>	<u>Percent</u>	<u>Contracts</u>	<u>Amount</u>	<u>Percent</u>	<u>Contracts</u>
	(000 omitted)			(000 omitted)		
Barber (note a)	\$ 8,515	50	68	\$8,381	50	82
Beauty (note a)	4,382	61	75	2,749	39	53
Florist (note a)	1,710	32	24	3,652	68	55
Photo- graphic (note a)	5,047	77	10	1,548	23	40
Theater snacks (note a)	1,816	76	51	566	24	15
Optical (note a)	8,941	74	87	3,130	26	27
Appliance rental/ repair	-	-	-	5,683	100	89
Watch repair	-	-	-	3,589	100	104
Laundry/dry cleaning	-	-	-	21,368	100	153
Shoe repair	-	-	-	<u>1,452</u>	100	<u>52</u>
Total	<u>\$30,411</u>	37	<u>315</u>	<u>\$52,118</u>	63	<u>650</u>

a/Sales for 7 months projected to a year (AAFES fiscal year 1976).

SHOULD NONAPPROPRIATED-FUND PROCUREMENTS BE
SUBJECT TO SMALL BUSINESS SET-ASIDES?

In furthering the Government's policy to protect the interest of small businesses, appropriated-fund procurements shall be set aside exclusively for small business participation to insure that, collectively, small businesses get a proportionate share of the Government's business.

AAFES officials believed that a set-aside program on its nonappropriated-fund procurements:

- Was not needed because small businesses, overall, had competed effectively under existing policies, a conclusion supported by the number of concession contracts held by small businesses.
- Would be detrimental to AAFES' basic mission because it would result in higher procurement costs due to (1) a lesser percentage of gross sales (smaller fee) being offered to the exchange by smaller businesses and (2) the administrative cost associated with a set-aside program. These additional costs would have to be passed on to its patrons in the form of higher prices or smaller contributions to the military services' welfare funds.

Although AAFES had not studied the impact of a set-aside program, its position is generally supported by the "Study of Procurement Payable from Nonappropriated Funds" prepared by the Executive Agency Nonappropriated Fund Procurement Study Group for the Administrator for Federal Procurement Policy. The study group concluded that:

"* * * the problems engendered by the use of the procurement process in the implementation of national goals are that the procurement becomes more costly and time consuming with the addition of each new social and economic program."

The study also notes that increased costs and time delays in the nonappropriated-fund procurement process resulting from such policies must be borne by the beneficiaries of the nonappropriated fund activities either as increased prices or as diminished support for morale, recreation, and welfare activities.

The study further points out that in appropriated-fund procurements, the additional cost of these programs is paid from the general revenues of the Government (i.e., all taxpayers share in the cost), whereas the extra cost burden on nonappropriated-fund procurement must be paid directly or indirectly, by the individual serviceman or civilian employee. Morale, welfare, and recreation activity beneficiaries already must bear any additional costs and time delays resulting from such programs as the Service Contract Act of 1965 (minimum wages), Rehabilitation Act of 1973 (employment of handicapped), and the Wagner-O'Day Act (purchase from the blind) which apply to nonappropriated-fund procurements.

Possible effect of a small business set-aside on exchange profits

There is no way to precisely determine the effect of a small business set-aside on either the exchanges or on the small business sector. A set-aside program might exclude some large businesses which offered higher fees to the exchanges, thus diminishing the exchanges' revenues from concession contracting.

It is possible that without the competitive influence of larger businesses, a lower fee might be offered by small businesses on a set-aside procurement. On the other hand, the lack of dominant large businesses also might encourage wider participation by small businesses and better overall offers from them.

Nevertheless, we attempted to estimate the possible effect a set-aside might have had on the award of exchange contracts, assuming the offers would not have been affected by the set-aside.

As of August 1976 AAFES had 278 barber and beauty concession contracts with estimated total annual sales of about \$24 million. We identified contracts held by large businesses and calculated the difference between the fees paid by the large business holding the contract and the highest fees offered by a small business. Had all contracts been set aside for small businesses, AAFES' income would have been reduced by over \$400,000 annually (about 10 percent) for these two services. However, a small business set-aside program is intended only to insure that small businesses receive a fair proportion of Government business; all contracts for a particular service need not be set aside for exclusive small business participation.

We did not attempt to validate the claim that a small business set-aside program would increase contract administration costs.

AWARDS OF CONTRACTS WITH SHORT LEADTIMES MAY BENEFIT LARGE BUSINESSES

As a result of congressional interest in AAFES' policies and procedures for awarding barber and beauty concession contracts, the Commander, AAFES, directed the Audit and Inspection Division to make a limited examination of AAFES contracting procedures. The Division selected two exchange regions for review. It found in one region that 43 percent of the barber and beauty contracts were awarded within less than the normal 30-day leadtime and in the other region, 28 percent. Some contracts were awarded within 13 to 14 days of announcement without an adequate explanation in the file as to the necessity for the short leadtime.

The Division concluded that short leadtimes favor large businesses because they have the experience to quickly develop and submit a bid. The report noted that one large business, a major contractor for exchange barber and beauty services, had received 40 percent of the short leadtime contracts in one region and 57 percent in the other.

Although it was not possible for us to determine if large businesses in fact benefited from this practice, a significant reduction in the normal 30-day leadtime for submitting offers might favor large businesses and reduce competition. Therefore, reasons for not complying with the normal 30-day leadtime should be valid and documented.

CONCLUSION AND RECOMMENDATION

Small businesses have been successful overall in competing for exchange concession contracts even though the exchanges had no small business set-aside programs and AAFES was awarding contracts within relatively short leadtimes. In recent years large businesses have received contracts to provide a greater share of certain services. The exchange services do not plan to extend to nonappropriated-fund procurements the protection currently provided to small businesses by ASPR because it would conflict with their mission to provide goods and services at the lowest practicable cost.

We have no way of estimating whether small businesses will continue to be successful in competing for exchange concession contracts or, if a set-aside program were imposed, what the effect would be on the exchanges and small business sector.

If, as contended, the return to the exchanges is reduced by imposition of a small business set-aside, the exchanges' ability to fund its own operations and provide funds to operate other morale, welfare, and recreation activities would be reduced.

Occasionally the question of self-sufficiency of morale, welfare, and recreation programs has been raised, including whether exchanges should generate funds to support other programs. We recently reported ^{1/} that, assuming correction of problems relating to inadequate accounting, we saw no technical reason why most of the appropriated-fund costs of the morale, welfare, and recreation activities could not be assumed by the activities. This conclusion was based partly upon an assumption of increased revenues from exchange operations. The absence of exchange revenues to support other activities would impose a burden on the other activities which they might not be able to assume without significantly increased sales programs. Nevertheless, whether the exchanges should operate in competition with private enterprises, be fully self-supporting, and provide revenues to support other activities are questions we believe should be more fully addressed.

With respect to short leadtime, we recommend that the Secretary of Defense require that AAPES contracting officers adequately document reasons why contracts are awarded within less than the normal 30-day leadtime.

^{1/}"Appropriated Fund Support for Nonappropriated Fund and Related Activities in the Department of Defense" (FPCD-77-58, Aug. 31, 1977).

CHAPTER 3

EFFECTIVENESS OF PROCEDURES TO PREVENT BUYING-IN

Buying-in refers to the practice whereby a contractor attempts to obtain a contract by knowingly making an offer which will result in no profit or a loss, with the expectation of having the contract changed after its award to make it more profitable. This practice should be avoided since its long-term effects may diminish competition and it may result in poor contractor performance. When buying-in is suspected to have occurred, contracting officers should assure themselves that intentional understatements of cost or price are not recovered through change orders or follow-on procurements.

Exchange concession contracts are usually awarded through competitive negotiation. Prospective offerers are told the prices to be charged for the services and the gross sales anticipated. Offerers must state the fee (percentage of gross sales) to be paid to the exchange. Contracts are awarded to the responsive and responsible business offering the highest fee. Buying-in on a concession contract may be attempted by contractors knowingly offering a fee so high as to preclude or endanger performance at the required standards with the expectation of getting relief through a fee reduction or an increase in price without an offsetting increase in fee.

AAFES PROCEDURES TO PREVENT BUYING-IN

AAFES procurement regulations address the problem of buying-in and specify steps to prevent it. Additionally, where buying-in may have already occurred, the regulations require steps to insure that subsequent contract amendments are not designed to bring relief to the contractor.

Initial contract

AAFES procurement regulations require contracting officers to determine that offers are reasonable, a mistake has not been made, and there has not been an attempt to buy in. If buying-in is suspected, the contracting officer must require the prospective contractor to demonstrate positively that he is capable and willing to fully perform the contract successfully at the offered price or fee. A cost analysis of an offerer's material, production, labor, general and administrative expenses, selling and overhead costs, plus other elements of cost and profit may be requested. If the offerer cannot provide such information, the contracting officer can find the offerer to be nonresponsible.

Contractor requests for a fee decrease (or price increase without offsetting fee increase) during the period of a contract may be favorably considered if the contractor has experienced increases in operating costs not anticipated at the time the contract was entered. Contractors may make written requests for relief, identifying those cost increases. This information and the contracting officers' determination as to whether a fee or price change is warranted become part of the contract file.

Contract renewals

AAFES normally awards concession contracts for an initial 2-year period with an option to extend for 2 years and a second option for 1 year more. Thus, if both options are exercised, a contract can run for 5 years without being resolicited. Only in unusual circumstances can contracts run longer than 5 years.

During fiscal year 1977 there were 439 concession contracts which expired. The disposition of these contracts is shown below.

	<u>Number of contracts</u>	
Extended by exercising option		309
Resolicited because:		
5-year period expired	108	
Requirements changed	4	
Additional advantage would result	3	
Poor contract performance	5	
Contractor refused to renew	<u>9</u>	
		129
Service discontinued		<u>1</u>
Total		<u><u>439</u></u>

Of the 439 contracts which expired, 108 had to be resolicited because of the 5-year limitation and contractors refused to agree to a renewal on 9 others. Thus, AAFES had no opportunity to renew 117 of the contracts. Of the remaining 322 (439 less 117), AAFES renewed 309 (96 percent).

At contract renewal, the contracting officer can authorize contract amendments for price increases for fee adjustments if, in the contracting officer's judgment, advantages beyond the best price and/or fee arrangements negotiated with the incumbent contractor are not available from other commercial sources. All actions leading to the final determination as to whether to amend or renew the current contract or to resolicit must be summarized in

writing and signed by the contracting officer. A copy of the determination must be placed in the contract file.

Analysis of selected contracts

We tested the effectiveness of the above procedures by reviewing the nature and extent of amendments on 223 current concession contracts for the 10 major services (see p. 6) at 37 selected Army and Air Force installations. Some contracts were recently awarded and some were nearly 5 years old. The selected contracts had a total of 137 contractor-initiated changes citing increased operating costs as the justification.

We identified contractor-requested amendments made during the first year of the contract because of the likelihood that (1) a contractor buying-in would seek relief as soon as possible and (2) older contracts would have changes in fee or price attributable to changing economic conditions. There were 36 first-year, contractor-requested amendments justified by increased operating costs. We requested supporting data for 26 (72 percent) of these 36 amendments and reviewed the steps taken by AAFES procurement personnel to insure that the contractor was not attempting to get relief from an earlier buy-in.

In addition, we analyzed other price increases on current barber contracts where there was a price increase offsetting fee adjustment. There were 31 such increases, including 5 contractor-requested amendments occurring during the first year.

On about 37 percent of the amendments reviewed, the documentary evidence was not sufficiently detailed to permit an independent postevaluation. We could draw no conclusions, therefore, as to whether the price or fee adjustments were warranted. We found no examples of unwarranted relief given to contractors in 63 percent of the cases where there was sufficient supporting evidence. AAFES procurement personnel generally were following the procedures discussed above.

We noted that AAFES' Audit and Inspection Division had concluded in a recent review of contracting practices that

"* * * it does appear that once a contract is awarded for two years, the incumbent can expect an automatic extension for an additional two years - - - and in many cases without a change

in fee although there had been price increases. Further, there was little evidence in writing in the file that an informed judgment had been made by the contracting officer regarding continuance of a contract."

NAVY AND MARINE CORPS PROCEDURES TO PREVENT BUYING-IN

We did not review the Navy and Marine Corps exchange procedures to prevent buying-in. Their exchange regulations do not specifically address the subject. NAVRESO, however, evaluates all price increases. We were told a request for a price increase will be denied if it is submitted a few months after the start of the contract. At the time of our review, there had not been a request for a price increase involving beauty shops. The one involving barber shops was denied because it was considered unreasonable.

The exchange officer at each Marine Corps installation has the responsibility of monitoring buy-ins. We were told that the price increases would be constrained by the local commander's desire to keep prices at the lowest level.

CONCLUSION AND RECOMMENDATION

It is obvious from the percentage of contracts renewed that a concession contractor can reasonably be assured of keeping a contract for 5 years if it provides satisfactory service. AAFES procedures recognize buying-in as an undesirable procurement practice which should be avoided and provide specific steps to prevent it. These procedures are adequate and, if conscientiously followed, should insure that price or fee adjustments do not give concessions contractors relief from buying-in. Generally, these procedures were being followed; but in some cases, poorly documented files prohibited determining whether price and fee adjustments were warranted.

We recommend that the Secretary of Defense require that AAFES officials insure that documentation to support contract changes is adequate for making such determinations at the time of change and for postevaluation.

CHAPTER 4

EMPLOYMENT OF FORMER EXCHANGE EMPLOYEES

BY CONCESSION CONTRACTORS

The exchanges do not keep data showing whether former exchange employees work for concession contractors; but from our discussions with AAFES officials, we believe this may not be uncommon. However, it is DOD's and AAFES' view that postemployment prohibitions applicable to persons who have ended their service with the exchanges are the same as for other activities within the executive branch. DOD Directive 5500.7 "Standards of Conduct," dated January 15, 1977, applicable to both appropriated- and nonappropriated-fund employees, sets forth DOD policy in this area and lists various laws applying to postemployment activities.

PROHIBITIONS IMPOSED BY STATUTE

18 U.S.C. 207(a) prohibits a former officer or employee from acting as agent or attorney for anyone other than the United States in connection with matters involving a specific party or parties in which the United States is one of the parties or has a direct or substantial interest and in which the former officer or employee participated personally and substantially while holding a Government position. Subsection (b) sets forth a 1-year postemployment prohibition on dealing in matters which were within the area of official responsibility of a former officer or employee at any time during the last year of service, but which do not come within subsection (a) because the former officer or employee did not participate in them personally or substantially. Subsection (b) prevents personal appearances in such matters before a court or a department or agency of the Government as agent or attorney for anyone other than the United States.

A retired regular officer may accept employment with private industry even if the employer is a contractor with the Government and has these same restrictions. In addition, 18 U.S.C. 283; Public Law 87-849§2 provides that within 2 years of retirement the officer cannot act as or assist an agent or attorney in prosecuting a claim against the Government or receive a gratuity or share of such claim in consideration for assistance if such claim involves the branch of service in which the officer holds a retired status. Further, a retired regular officer is prohibited at all times by 18 U.S.C. 281;

Public Law 87-849§2 from receiving any compensation for representing any persons in the sale of anything to the Government through the department in whose service the officer holds a retired status. Also, a retired regular officer, for a period of 3 years following retirement, is subject to loss of retired pay while engaged in selling supplies or war materials to any of the uniformed services under 37 U.S.C. 801(c).

AAFES requires all former officers and employees to complete a form entitled "Notice of Appearance Before Exchange Activity" before they can conduct any business with AAFES. This form addresses the restrictions imposed by 18 U.S.C. 207. The former officer or employee must certify his/her military status and whether his/her business concerns his/her area of responsibility or military department. The Navy and Marine Corps exchanges do not have a similar requirement.

COMPETITIVE CONCESSION PROCUREMENTS REDUCE RISK OF UNDUE INFLUENCE BY FORMER EMPLOYEES

The exchanges award substantially all concession contracts competitively. This minimizes the influence that a former exchange employee can have on an award since the award is made to the responsive and competent business offering the highest fee to the exchange.

Under competitive procedures a firm attempting to improve its chances for a contract award can do so if it has access to relevant facts not available to competing firms, or if confidential information is disclosed prior to opening offers. A former employee would not have direct access to confidential information that would give a new employer an unfair competitive advantage without collusion with a current exchange representative. A former exchange employee's expertise could help a concessionaire better manage a concession contract because of his knowledge of and familiarity with regulations and procedures, but the procurement-related information the former employee has to offer would be available to all interested offerers. We reviewed AAFES' procedures for controlling offers from the time of initial receipt until opening and found them to be adequate. We noted also that AAFES' Audit and Inspection Division had reached similar conclusions in its reviews.

There is always the possibility that close personal relationships--whether the result of former association as coworkers, or other circumstances--can affect the day-to-day management decisions that occur after the contract is awarded. Any procurement process, no matter how

well controlled, must rely on a high degree of employee integrity to insure that conflicts of interest are avoided and the Government's best interests are served. Our review of a considerable amount of information pertaining to AAFES' concession contracts, although not necessarily conclusive, disclosed no evidence that former employees are unduly influencing concession contracting. Additionally as a part of our continuing efforts in the field, we initiated a review of AAFES' code of ethics and financial disclosure system and will be examining its postemployment regulations and procedures in greater detail.

PROPOSED POLICY CHANGE BY AAFES

On February 9, 1977, AAFES issued a letter to concerns with which it does business stating that in the near future it intended to amend its procurement regulations in which vendor representatives would be requested, in addition to completing the form "Notice of Appearance Before Exchange Activity," to show evidence of authority to represent the vendors. In conjunction with noncompetitive procurement, a retired officer assigned to AAFES or former AAFES employee in grade 12 or above would not be permitted to do business with AAFES for a period of 4 years after retirement. A "grandfather clause" to exempt prior employees or officers from the 4-year waiting period was not included.

At the time our field work was completed, the proposed change had not been implemented. If implemented, AAFES' policy will be more restrictive than policies applicable to other executive branch personnel. It would not apply to concessionaires under competitive procurements.

CHAPTER 5

REASONABLENESS OF PRICES CHARGED RECRUITS FOR HAIRCUTS

The reasonableness of prices for haircuts received by recruits during basic training periods depends upon the complexity of the haircuts and the time taken to give them. Basic training is 6 weeks for the Army and Air Force, 8 weeks for the Navy, and 12 weeks for the Marines. There are seven Army, one Air Force, three Navy, and two Marine Corps installations where recruits receive their initial training.

TYPE AND FREQUENCY OF RECRUIT HAIRCUTS

The following haircut standards were applicable to recruits:

- Army: The type and frequency of haircuts during the 5-week training period vary between installations. The initial haircut varies from the traditional close-cropped type to one with close-cropped sides and one-half to 2 inches long on top. Recruits have some latitude on subsequent haircuts but in some instances must conform to standards established for recruits by local commands which are more restrictive than the standard for nonrecruits.
- Air Force: Three close-cropped haircuts are received during the 6-week basic training period.
- Navy: About five haircuts are received during the 8-week basic training period. The first haircut is the traditional close-cropped type, but afterwards recruits have the option to let hair grow progressively longer and only have it trimmed until it conforms to the dress code standard for nonrecruits.
- Marines: About six close-cropped haircuts are received during the first 10 weeks of the basic training period; afterwards they may let their hair grow longer and only a trim is required.

Comparing the haircuts received by recruits is difficult because of the different standards adopted by the military services and variations between local commands within a service. But there are some apparent differences. Air Force and Marine recruits essentially have no option as to the type

and frequency of haircuts they receive. Army recruits may have some option as to how often they get a haircut and the length of their hair, but their options may be severely limited as a result of requirements established by local commands. For example, recruits at Fort Leonard Wood are required to have close-cropped sides throughout basic training. Navy recruits appear to have the greatest latitude. After Navy recruits receive their initial haircut, they only have to conform to the standard applicable to other Navy personnel.

PRICING POLICIES VARY AMONG THE SERVICES

Prices charged recruits are the result of pricing policies established independently by each exchange system. Haircut prices at recruit training installations as of February 28, 1977, varied from \$0.62 to \$1.25 as shown in the following table.

	<u>Recruits</u>	<u>Other personnel</u>
Army (note a):		
Fort Jackson	\$1.05	\$1.75
Fort Leonard Wood	1.05	1.75
Fort Knox	1.15	1.95
Fort Bliss	1.15	1.90
Fort Dix	1.20	2.00
Fort Sill	1.20	2.00
Fort McClellan	1.00	1.65
Air Force:		
Lackland Air Force Base	1.00	1.95
Navy:		
Great Lakes Naval Training Center	1.25	2.00
Orlando Naval Training Center	1.00	1.50
San Diego Naval Training Center	1.00	1.50
Marine Corps:		
San Diego Recruit Depot	<u>b</u> /.75	1.50
Parris Island Recruit Depot	.62	1.30

a/Recruit price is for first haircut only. Prior to February 28, 1977, recruit prices were the same as for other personnel.

b/\$1.00 for the last 2 weeks of training.

Army and Air Force

AAFES' pricing policy is to set prices for services at 20 to 25 percent below prevailing prices in the local community. Surveys are made to determine local prices. Pricing policies stipulate that haircut prices cannot be increased more than 25 cents at any time or more frequently than every 6 months.

Prior to February 28, 1977, haircut prices were the same for Army recruits as for other Army personnel even though there was a difference between the hair cutting service provided. On the other hand, Air Force recruits were paying a reduced haircut price of about 49 percent below the price set for regular haircuts. Thus, there was an obvious inconsistency in haircut pricing for Air Force and Army recruits.

As a result of congressional interest, AAFES reviewed its haircut pricing policy and decided to reduce the price of the initial haircut for Army recruits to a price 40 percent below the price of a regular haircut, effective February 28, 1977. AAFES concluded that a 40-percent reduction was reasonable considering concessionaire labor and overhead expense requirements. They reasoned that the reductions should apply only to the first haircut because Army trainees are given latitude for individual grooming desires on subsequent haircuts.

Navy and Marine Corps

Navy prices for barber services are keyed to the cost of providing the service plus a profit of 10 percent. Prices are set by each installation commander. Price surveys are made in local communities to insure that exchange prices are competitive. Prices for recruit haircuts were set below the regular haircut price to recognize a difference in the service received (i.e., length of time in the barber chair) but were influenced to some degree by the need to generate sufficient commissions to retain qualified barbers. A Marine Corps exchange official also told us its policy is to have a lower markup on items or services, such as haircuts, which personnel are required to purchase.

CONCLUSION AND RECOMMENDATION

AAFES' policy of setting haircut prices at 20 to 25 percent below prices prevailing in the local community is essentially a profit-based policy. Prices are increased

as outside market conditions permit, rather than as demanded by increased costs or too little profit. If costs do not rise commensurately with the rise in local prices, more profit will be made.

Navy and Marine Corps pricing policies seem to place less emphasis on profit. Prices are increased when necessary to cover increased cost or to generate minimum project objectives. Price increases for similar services in the local community do not, in themselves, trigger increases in exchange prices.

Unlike Navy, Marine Corps, and Air Force recruits who benefit from a reduced haircut price throughout basic training, the Army recruit gets a price break only on his initial haircut. There are some obvious differences between the haircuts given Air Force and Marine recruits and those given Army recruits. But we see no difference between Army and Navy recruits which would justify a higher price for Army recruits and, in fact, the options provided Navy recruits seem closer to those available to nonrecruits than does the Army's. Except for this apparent inconsistency in pricing policies, we believe haircut prices for recruits are reasonable when compared with regular haircut prices at each location.

We therefore recommend that the Secretary of Defense require AAFES to offer reduced prices on follow-on Army recruit haircuts.